

## RIDGEWORTH INSIGHTS: TAX-EXEMPT FIXED INCOME



*Collective Strength. Individual Insight.*



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### RIDGEWORTH FUNDS

RidgeWorth Seix Investment Grade  
Tax-Exempt Bond

RidgeWorth Seix High Grade Municipal Bond

RidgeWorth Seix Short-Term Municipal Bond

RidgeWorth Seix Georgia Tax-Exempt Bond

RidgeWorth Seix North Carolina Tax-Exempt  
Bond

RidgeWorth Seix Virginia Intermediate  
Municipal Bond

### EXECUTIVE SUMMARY

- Performance during the quarter was strong, as net inflows continued to be robust while new issuance came in lower than expected.
- Fundamentals have plateaued, and pension underfunding will present a headwind for some municipal issuers in coming months. States and local governments that are able to implement pension reform are likely to outperform.
- We remain bullish, given that muni yields continue to look attractive relative to Treasuries and foreign government debt.

The municipal bond market turned in a strong performance during the second quarter, as robust inflows once again outpaced net supply, continuing a trend that began in the fourth quarter of 2015. Inflows to municipal mutual funds alone totaled \$33 billion year-to-date through June 29, 2016, while the gross supply of new issues of \$85 billion for the quarter was less than expected. The Barclays Municipal Bond Index rose 2.61% during the quarter.

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In June, the U.S. Supreme Court ruled against Puerto Rico's plan to allow its municipalities and enterprise funds to declare Chapter 9 bankruptcy. To address the crisis, the U.S. House has passed a bill that would appoint a panel to oversee a relief program. This bill is likely to be passed by the U.S. Senate. A separate moratorium on debt payments passed by Puerto Rico in April is also likely to be struck down. We have not held any Puerto Rico debt since 2013, and we remain negative on the credit.

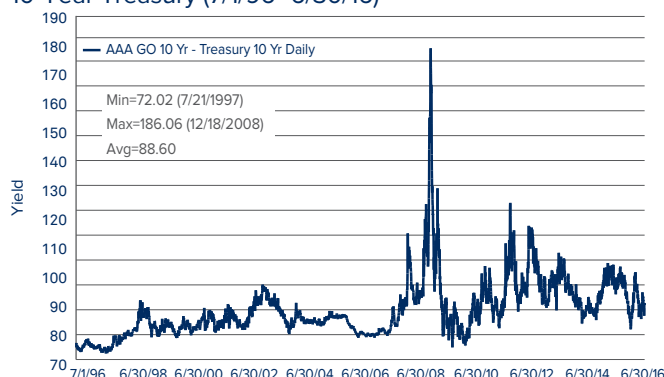
**YIELD CURVE FLATTENS**

Domestic and international events combined to flatten the municipal yield curve during the quarter in a market environment that was largely unanticipated just six months ago. The two- to 10-year yield spread on AAA-rated munis has dropped from 103 basis points (bps) to just 77 bps, while the spread between five- and 10-year AAA munis has fallen from 63 bps to 46 bps. On the long end of the curve, 10- to 30-year yield spread fell from 99 bps to 67 bps.

The flattening of the yield curve in the second quarter underscores the difficulty of predicting the direction of interest rates and the wisdom of a duration-neutral strategy. At the end of 2015, many observers were expecting two or three interest rate hikes by the Federal Reserve Board. Today, in a weaker economic environment with rising global turmoil, few expect more than one or two, and a rate cut may even be on the table. We believe further flattening may be in store.

Ratios of muni yields to Treasury yields remain tight. The yield on 10-year AAA munis, for example, has improved from about 98% of the 10-year Treasury several months ago to about 90% today. But this is still above the long-term average, and we believe further improvement is possible. For investors in high tax brackets, munis would be advantageous even if this ratio were to improve to the low 80s.

**Exhibit 1: 10-Year AAA Municipal Bond Yield vs 10-Year Treasury (7/1/96–6/30/16)**



Source: The Municipal Market Monitor; Date pulled: 7/7/16.

**FUNDAMENTALS HAVE PLATEAUED**

Muni market credit fundamentals peaked in 2015, and in some jurisdictions tax revenues have even declined. States seeing drop-offs include those dependent on the energy industry, including oil, natural gas and coal.

In the coming months, pension costs could also present a significant headwind for some states and municipalities. The pension underfunding ratio of state and local pension plans worsened in 2015 from 74% to 72%, due largely to weakness in equity markets. In the near term, this weakness is likely to continue, given the uncertainty arising from the United Kingdom (UK) vote to leave the European Union (Brexit).

Continued equity underperformance could require some states and municipalities with pension shortfalls to make larger plan contributions just to maintain current funding levels. Last year, in fact, pension expenditures of state and local governments increased 9%. Some spread-widening is likely for those credits with underfunded pension plans and other post-employment benefit obligations.



Collective Strength. Individual Insight.

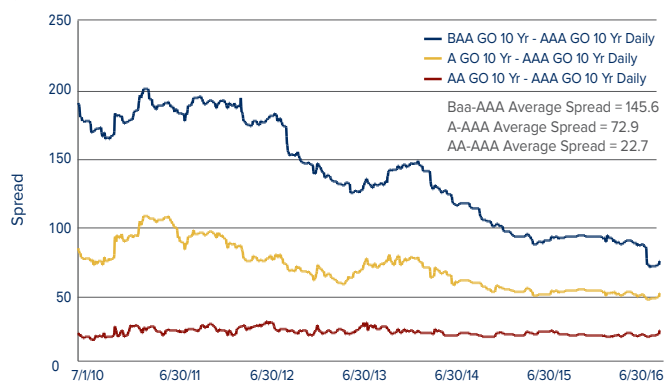
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## OUR OUTLOOK

Nevertheless, we anticipate that the municipal bond market will remain strong. Demand should continue to be robust, given significant redemptions and reinvestments expected in July and August. This, combined with relatively little new supply, could put further downward pressure on yields.

In the lower-quality parts of the market, however, we don't believe that investors are being compensated adequately for the associated risk. These credits may come under pressure in the event of a global recession or a domestic slowdown.

**Exhibit 2: Historical Credibility Quality Spreads**  
(7/1/10–6/30/16)



Source: The Municipal Market Monitor; Date pulled: 7/7/16.

A Basis Point is equal to 0.01%.

Credit Ratings noted herein are calculated based on S&P, Moody's and Fitch ratings. Generally, ratings range from AAA, the highest quality rating, to D, the lowest, with BBB and above being called investment grade securities. BB and below are considered below investment grade securities. If the ratings from all three agencies are available, securities will be assigned the median rating based on the numerical equivalents. If the ratings are available from only two of the agencies, the more conservative of the ratings will be assigned to the security. If the rating is available from only one agency, then that rating will be used. Any security not rated by S&P, Moody's, or Fitch is placed in the NR (Not Rated) category. Ratings do not apply to a fund or to a fund's shares. Ratings are subject to change.

Credit Spreads are the difference between the yields of sector types and/or maturity ranges.

Duration is a measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years.

Yield Curve is a curve that shows the relationship between yields and maturity dates for a set of similar bonds, usually Treasuries, at any given point in time.

Barclays Municipal Bond Index is a widely recognized index of investment grade tax-exempt bonds. The eight subsets of the Index are market weighted. The Index includes general obligations, revenue bonds, insured bonds, and pre-refunded bonds. Investors cannot invest directly in an index.

### Investment Risks:

Bonds offer a relatively stable level of income, although bond prices will fluctuate providing the potential for principal gain or loss. Intermediate-term, higher-quality bonds generally offer less risk than longer-term bonds and a lower rate of return.

We continue to favor states in the southeast and the west, and to avoid states dependent on commodities. We also prefer issues that are revenue-based, such as transportation and special tax. On the other hand, we believe spreads in some sectors, such as Healthcare, are too tight.

On an absolute basis, yields are low but could decline further, given their relative attractiveness. For foreign investors, municipal bonds continue to hold appeal versus U.S. and foreign government debt, particularly in the wake of the UK vote to leave the European Union and continued negative global yields.

With attractive after-tax yields versus Treasuries, and with comparative stability versus equities and other asset classes, munis should continue to hold appeal for both domestic and foreign investors.

Generally, a fund's fixed income securities will decrease in value if interest rates rise and vice versa. A fund's income may be subject to certain state and local taxes and, depending on your tax status, the federal alternative minimum tax. The geographical concentration of portfolio holdings in a fund may involve increased risk.

The views expressed herein are as of the quarter-end specified. This information is general in nature, provided as general guidance on the subject covered, and is not intended to be authoritative. It is subject to change without notice as market conditions change, and is not intended to predict the performance of any individual security, market sector, or RidgeWorth Fund. All information contained herein is believed to be correct, but accuracy cannot be guaranteed. Investors are advised to consult with their investment professional about their specific financial needs and goals before making any investment decision.

**Before investing, investors should carefully read the prospectus or summary prospectus and consider the fund's investment objectives, risks, charges and expenses. Please call 888.784.3863 or visit [ridgeworth.com](http://ridgeworth.com) to obtain a prospectus or summary prospectus, which contains this and other information about the funds.**

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## ABOUT RIDGEWORTH INVESTMENTS

RidgeWorth Investments—a global investment management firm headquartered in Atlanta, Georgia with approximately \$37.0 billion in assets under management as of June 30, 2016—offers investors access to a select group of boutique investment managers and subadvisers. RidgeWorth wholly owns three boutiques: Ceredex Value Advisors LLC, Seix Investment Advisors LLC and Silvant Capital Management LLC, and holds a minority ownership in Zevenbergen Capital Investments LLC. WCM Investment Management and Capital Innovations, LLC serve as subadvisers to the RidgeWorth Funds. Through these six investment managers, RidgeWorth offers a wide variety of fixed income and equity disciplines, providing investment management services to a growing client base that includes institutional, individual and high net worth investors.

For more information about RidgeWorth, its boutiques and its subadvisers, visit **ridgeworth.com**.



## ABOUT SEIX INVESTMENT ADVISORS LLC

Seix Investment Advisors, one of RidgeWorth's investment management boutiques, has exclusively focused on managing fixed income assets since 1992. Seix seeks to generate competitive absolute and relative risk-adjusted returns over the full market cycle through a bottom-up focused, top-down aware process. Seix employs multi-dimensional approaches based on strict portfolio construction methodology, sell disciplines and trading strategies with prudent risk management as a cornerstone.

For more information about Seix, visit **seixadvisors.com**.